



MARKSCHEME

November 2005

ECONOMICS

Higher Level

Paper 1

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Paper Specific Markscheme

In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated. Examiners should be aware that candidates may take a different approach, which if appropriate should be fully rewarded.

1. (a) Explain the differences between monopolistic competition and oligopoly as market structures. [10 marks]

- large number of firms (m.c) versus a few dominant firms (oligopoly)
- differentiated product (m.c) versus differentiated or standardized (oligopoly)
- low barriers to entry (m.c) versus high barriers to entry (oligopoly)
- interdependence of firms in oligopoly
- comparison of the demand curves

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

(b) Discuss the differences between a collusive and a non-collusive oligopoly. [15 marks]

Collusive Oligopoly

- formal (cartel) or informal agreement (tacit collusion) among producers to limit competition between themselves
- they act as if they were a monopoly
- discussion of the consequences of the firms acting as a monopoly
- impact on consumers
- members may compete against each other using non-price competition
- regulations to prevent collusion

Non-Collusive Oligopoly

- no agreement exists between producers
- existence of non-price competition with the possibility of price wars
- the kinked demand curve as one model to describe oligopoly behaviour
- game theory
- contestability of markets prevents firms from exploiting monopoly power

It would be possible to earn full marks on this question without using diagrams, however use of appropriate diagrams should be rewarded.

Discussion (in part (b)) of **only** a collusive or **only** a non-collusive oligopoly should be awarded up to a maximum of **[7 marks]**.

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2. (a) **Explain the relationship between the Lorenz Curve and the Gini Coefficient.** **[10 marks]**

Lorenz Curve

- a curve showing the proportion of national income earned by any given percentage of the population
- used to show the degree of inequality of income in a society
- the farther from the 45° line is the curve, the greater the degree of inequality

Gini Coefficient

- a statistical measure of the degree of income inequality
- measures the area between the 45° line and the Lorenz Curve as a proportion of the entire area under the 45° line
- ranges between 0 and 1
- a Gini Coefficient of 0 represents complete equality; coefficient of 1 represents complete inequality

Up to a maximum of **[6 marks]** if there is no diagram(s).

Up to a maximum of **[5 marks]** if the relationship between the Lorenz Curve and the Gini Coefficient is not examined.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

- (b) **Evaluate the effectiveness of the various methods that governments may use to redistribute income.** **[15 marks]**

- explanation of the different forms of taxation and how they can be used to redistribute income
- discussion of the issues associated with using taxes to redistribute income
- explanation of transfer payments made by government
- discussion of the issues associated with transfer payments
- subsidies
- merit and public goods

Up to **[15 marks]** can be awarded for a full discussion and evaluation of two methods. Up to **[15 marks]** can be awarded for a less than full discussion of three or more methods but evaluation must occur; [recognising the time constraint].

Answers which are effectively a list and are without evaluation can be awarded up to **[6 marks]**. A discussion of one method with evaluation can be awarded up to **[7 marks]**.

Different forms of taxation are to be seen as one method. In the same way different forms of transfer payment, subsidies, merit goods and public goods are to be each seen as one method.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

3. (a) **Explain the concepts of trade creation and trade diversion.** **[10 marks]**

Trade Creation

- results from a country joining a trading bloc
- consumption shifts from a high-cost producer to a low-cost producer
- removal of trade barriers allows greater specialization according to comparative advantage

Trade Diversion

- results from the formation of a trading bloc
- consumption shifts from a lower-cost producer outside the trading bloc to a higher-cost producer within the trading bloc
- there is a net loss in world welfare

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

- (b) **Evaluate the advantages *and* disadvantages of joining a trading bloc.** **[15 marks]**

The answer should identify the type of trading bloc under discussion (free trade area, customs union or common market).

Advantages

- possibility of economies of scale
- increased competition leads to efficiency and lower prices
- productive and allocative efficiency
- greater consumer choice
- transfer of labour and capital in a customs union or a common market

Disadvantages

- increased competition can force inefficient domestic producers out of the market
- domestic workers may be unemployed
- short run gains versus the possibility of increased mergers (less competition) in the long run
- the gains of the trading bloc may be distributed unevenly
- loss of economic sovereignty

If a candidate discusses only one advantage and/or one disadvantage then award up to **[4 marks]** for that advantage and/or disadvantage.

If a candidate discusses and evaluates **only** advantages or **only** disadvantages then award up to **[7 marks]**.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

4. (a) Explain *two* significant barriers to economic growth in LDCs. [10 marks]

Candidates may distinguish between economic growth and economic development, but the focus of the answer must be on economic growth.

- vicious cycle of poverty
- institutional and political factors
- MDC protectionism
- indebtedness
- social and cultural factors

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

(b) Evaluate strategies that may be used to overcome the two barriers identified in (a). [15 marks]

- Aid
- FDI
- greater access to MDC markets
- reduced subsidies from MDC governments to MDC producers
- inward-oriented versus outward-oriented strategies
- investment in human capital

If a list (*i.e.* without evaluation) up to **[5 marks]**.

If only one strategy discussed and evaluated up to **[7 marks]**.

For a full discussion and evaluation of two strategies up to **[15 marks]**.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.
